

[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-155929-06]

RIN 1545-BG31

Payout Requirements for Type III Supporting Organizations that are not Functionally Integrated

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Advance notice of proposed rulemaking.

SUMMARY: This document describes rules that the Treasury Department and the IRS anticipate proposing, in a notice of proposed rulemaking, regarding the payout requirements for Type III supporting organizations that are not functionally integrated, the criteria for determining whether a Type III supporting organization is functionally integrated, the modified requirements for Type III supporting organizations that are organized as trusts, and the requirements regarding the type of information a Type III supporting organization must provide to its supported organization(s) to demonstrate that it is responsive to its supported organization(s). Sections 1241 and 1243 of the Pension Protection Act of 2006 amended the law with respect to Type III supporting organizations prompting a need to revise the Treasury Regulations regarding the four matters mentioned above. These new requirements and criteria would apply to Type III supporting organizations as defined under sections 509(a)(3)(B)(iii) and 4943(f)(5) of the Internal Revenue Code (Code). This document also invites

comments from the public regarding the proposed payout requirement and the proposed criteria for qualifying as functionally integrated. All materials submitted will be available for public inspection and copying.

DATES: Written or electronic comments must be submitted by October 31, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-155929-06), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-155929-06), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, D.C., or sent electronically via the Federal eRulemaking Portal at <http://www.regulations.gov/> (IRS REG-155929-06).

FOR FURTHER INFORMATION CONTACT: Concerning submissions, Richard A. Hurst at (202) 622-2949 (TDD Telephone) and his e-mail address is [Richard.A.Hurst@irs.counsel.treas.gov](mailto:Richard.A.Hurst@irs.counsel.treas.gov); concerning the proposed rules, Philip T. Hackney or Michael B. Blumenfeld at (202) 622-6070 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

##### **Background**

The Pension Protection Act of 2006, Pub. L. No. 109-280, 120 Stat. 780 (2006) (PPA), amended the requirements that an organization exempt from tax under section 501(c)(3) of the Code must meet to qualify as a Type III supporting organization under section 509(a)(3) of the Code. This advanced notice of

proposed rulemaking describes the rules that the Treasury Department and the IRS expect to propose to implement the new qualification requirements for Type III supporting organizations enacted by Congress and solicits comments from the public.

### *Public Charities versus Private Foundations*

Under section 509(a), an organization described in section 501(c)(3) is a private foundation unless it meets the requirements of section 509(a)(1), (2), (3), or (4). Organizations described in section 501(c)(3) that meet the requirements of section 509(a)(1), (2), (3), or (4) are referred to as public charities.

Private foundations, which are generally divided into two categories, operating and non-operating, depending on the type of activity in which the foundation engages, are subject to a different set of requirements than those applicable to public charities. Sections 4940 through 4948 impose various restrictions and excise taxes on private foundations along with their disqualified persons and foundation managers, that are generally not applicable to public charities. Furthermore, more stringent deduction limitations apply to contributions made to private non-operating foundations than apply to contributions to public charities. For example, under section 170(b)(1)(A), an individual who makes a cash contribution to a public charity may deduct up to fifty percent of his or her contribution base (a modified adjusted gross income amount) in the year of his or her contribution, while the same contribution to a private non-operating foundation would be limited to thirty percent of the individual's contribution base under section 170(b)(1)(B). In addition, deductions

for contributions of certain appreciated property to a private non-operating foundation are limited to the contributor's basis in the property under section 170(e)(1)(A), while the same contribution to a public charity could result in a deduction based on the property's fair market value under section 170(e)(1)(B)(ii).

### Supporting Organizations

Public charities that meet the requirements of section 509(a)(3) are known as supporting organizations. To be classified as a supporting organization, an organization must satisfy an organizational test, an operational test, a relationship test, and a disqualified person control test. The organizational and operational tests require that the organization be organized and at all times thereafter operated exclusively for the benefit of, to perform the functions of, or to conduct the purposes of one or more publicly supported organizations described in section 509(a)(1) or (2). The relationship test requires that the organization be operated, supervised, or controlled by or in connection with one or more publicly supported organizations. Finally, the disqualified person control test requires that the organization not be controlled directly or indirectly by certain disqualified persons.

### Relationship Test

Treasury Regulation (Treas. Reg.) §1.509(a)-4(f)(2) sets forth three structural or operational relationships a supporting organization is permitted to have with its supported organization(s). Each supporting organization must have one of the three types of relationships with the organization(s) it supports to be a

supporting organization described in section 509(a)(3) of the Code. The purpose of the relationship requirement is to ensure that a supporting organization has a sufficiently close tie to one or more publicly supported organizations such that the supporting organization will be accountable to a broader public constituency.

A supporting organization that is operated, supervised or controlled by one or more publicly supported organizations is commonly known as a Type I supporting organization. The relationship a Type I supporting organization has with its supported organization(s) is comparable to that of a parent-subsidary relationship. A supporting organization supervised or controlled in connection with one or more publicly supported organizations is commonly known as a Type II supporting organization. The relationship a Type II supporting organization has with its supported organization(s) is comparable to a brother-sister corporate relationship. A supporting organization that is operated in connection with one or more publicly supported organizations is commonly known as a Type III supporting organization.

*Qualification Requirements for Type III Supporting Organizations Prior to Enactment of the Pension Protection Act*

In general, Treas. Reg. §1.509(a)-4(i)(1) requires an organization to meet a “responsiveness test” and an “integral part test” to satisfy the relationship requirement for a Type III supporting organization.

*Responsiveness Test: General Rule.* Treas. Reg. §1.509(a)-4(i)(2)(i) provides that an organization is “considered to meet the ‘responsiveness test’ if the organization is responsive to the needs or demands of” its publicly supported

organizations. Treas. Reg. §1.509(a)-4(i)(2)(ii) provides that a supporting organization may demonstrate responsiveness to its publicly supported organization(s) if: (1)(a) one or more of its officers, directors, or trustees are elected or appointed by the officers, directors, trustees, or membership of its publicly supported organization(s), (b) one or more members of the governing bodies of its publicly supported organization(s) are also officers, directors, or trustees of, or hold other important offices in, the supporting organization, or (c) the officers, directors, or trustees of the supporting organization maintain a close, continuous working relationship with the officers, directors, or trustees of its publicly supported organization(s); and (2) by reason of such arrangement, the officers, directors, or trustees of its publicly supported organization(s) have a significant voice in the investment policies of the supporting organization, the timing and the manner of making grants, the selection of the grant recipients by the supporting organization, and otherwise directing the use of the income or assets of the supporting organization.

In addition, with respect to an organization that was supporting a publicly supported organization before November 20, 1970, Treas. Reg. §1.509(a)-4(i)(1)(ii) provides that additional facts and circumstances, such as a historic and continuing relationship between the supporting organization and its supported organization(s), may be taken into account, in addition to the factors described in the general responsiveness test above, to establish compliance with the responsiveness test.

*Responsiveness Test: Charitable Trusts.* Before enactment of the PPA, one way of satisfying the responsiveness test, under Treas. Reg. §1.509(a)-4(i)(2)(iii), required that (1) the supporting organization be a charitable trust under state law, (2) each publicly supported organization that the trust supports be named as a beneficiary under the charitable trust's governing instrument, and (3) each beneficiary organization have the power to enforce the trust and compel an accounting under State law. As described below, this method of satisfying the responsiveness test was effectively removed by the PPA.

*Integral Part Test.* Treas. Reg. §1.509(a)-4(i)(3)(i) provides that a supporting organization is required to establish that “it maintains a significant involvement in the operations of one or more publicly supported organizations and such publicly supported organizations are in turn dependent upon the supporting organization for the type of support which it provides.” Treas. Reg. §1.509(a)-4(i)(3)(ii) and (iii) sets forth two alternative ways to meet the integral part test. The first method is typically referred to as the “but for” test. In this advance notice of proposed rulemaking, the second method of meeting the integral part test will be referred to as the “attentiveness” test.

*Integral Part Test, Alternative I: the “but for” test.* Under Treas. Reg. §1.509(a)-4(i)(3)(ii) the “but for” test is satisfied if “the activities engaged in [by the supporting organization] for or on behalf of the publicly supported organizations are activities to perform the functions of, or to carry out the purposes of, such organizations, and, but for the involvement of the supporting

organization, would normally be engaged in by the publicly supported organizations themselves.”

*Integral Part Test, Alternative II: the “attentiveness” test.* The “attentiveness” test, under Treas. Reg. §1.509(a)-4(i)(3)(iii), requires a supporting organization to (1) make payments of substantially all of its income to or for the use of one or more publicly supported organizations, (2) provide enough support to one or more publicly supported organizations to insure the attentiveness of such organizations to the operations of the supporting organization, and (3) pay a substantial amount of the total support of the supporting organization to those publicly supported organizations that meet the attentiveness requirement. Rev. Rul. 76-208, 1976-1 CB 161, (see §601.601(d)(2) of this chapter), provides that the phrase “substantially all of its income” in Treas. Reg. §1.509(a)-4(i)(3)(iii) means at least 85 percent of its adjusted net income.

*PPA Amendments to Qualification Requirements for Type III Supporting Organizations*

The PPA amended the qualification requirements for Type III supporting organizations, modifying both the integral part test and the responsiveness test.

Sections 1241 and 1243 of the PPA enacted Code sections 509(d) and 4943(f)(5). These provisions define the term Type III supporting organization and distinguish between functionally integrated and non-functionally integrated Type III supporting organizations. These two new categories appear to reflect the distinction drawn in the Treasury Regulations between those organizations that

meet the integral part test by meeting the “but for” test and those that meet the integral part test by meeting the “attentiveness” test.

In conformity with existing Treasury Regulations, new section 4943(f)(5)(A) defines a Type III supporting organization as a supporting organization that is operated in connection with one or more section 509(a)(1) or (2) organizations. New section 4943(f)(5)(B) defines a functionally integrated Type III supporting organization as a Type III supporting organization that is not required under regulations established by the Secretary to make payments to supported organizations due to the activities of the organization related to performing the functions of, or carrying out the purposes of, such supported organizations. Although this language appears similar to the “but for” prong of the integral part test, the Staff of the Joint Committee on Taxation in its technical explanation of the provision notes that there is “concern that the current regulatory standards for satisfying the integral part test not by reason of a payout [i.e., the existing “but for” test] are not sufficiently stringent to ensure that there is a sufficient nexus between the supporting and supported organizations.” See Staff of the Joint Committee on Taxation, *Technical Explanation of H.R. 4, the “Pension Protection of 2006,” as Passed by the House on July 28, 2006, and as Considered by the Senate on August 3, 2006* (JCX-38-06) at 360 n. 571, August 3, 2006 (Technical Explanation). In particular, the Technical Explanation states that in revising the Type III supporting organization regulations the Secretary “shall strengthen the standard for qualification as [a Type III supporting] organization that is not required to pay out.” *Id.*

Section 1241(d)(1) of the PPA directed the Secretary to promulgate new regulations on the payments required by Type III supporting organizations that are not functionally integrated. Section 1241(d)(1) of the PPA provides that such regulations shall require non-functionally integrated Type III supporting organizations to make distributions of a “percentage of either income or assets to supported organizations (defined in new section 509(f)(3) of [the] Code) in order to ensure that a significant amount is paid” to their supported organizations. The Technical Explanation notes that there is concern that merely requiring a Type III supporting organization to pay out substantially all of its net income (as under the “attentiveness” prong of the integral part test) does not necessarily result in significant distributions to publicly supported organizations relative to the value of the assets held by the Type III supporting organization and “as compared to amounts paid out by nonoperating private foundations.” See Technical Explanation at 360 n. 571.

Section 1241(c) of the PPA modified the responsiveness test as it applies to charitable trusts. Effectively, section 1241(c) provides that having each organization that the trust supports be a publicly supported organization named as a beneficiary under the trust’s governing instrument and establishing that each beneficiary organization has the power to enforce the trust and compel an accounting is no longer sufficient to satisfy the responsiveness test as provided in Treas. Reg. §1.509(a)-4(i)(2)(iii). The Technical Explanation states that a Type III supporting organization organized as a trust must now “establish to the satisfaction of the Secretary, that it has a close and continuous relationship with

the supported organization such that the trust is responsive to the needs or demands of the supported organization.” Technical Explanation at 362. Under section 1241(e)(2)(A) of the PPA, trusts that operated in connection with a publicly supported organization on August 17, 2006, have until August 17, 2007 to satisfy the modified responsiveness test under Treas. Reg. 1.509(a)-4(i)(2)(ii). For other trusts, the provision was effective on August 17, 2006.

Finally, section 1241(b) added section 509(f)(1)(A), which contains another requirement for Type III supporting organizations. The provision requires a Type III supporting organization to provide each of its supported organizations with “such information as the Secretary may require to ensure that such organization is responsive to the needs or demands of the supported organization.”

As described in this advanced notice of proposed rulemaking, the Treasury Department and the IRS intend to propose regulations that provide (1) the payout requirements for Type III supporting organizations that are not functionally integrated, (2) the criteria for determining whether a Type III supporting organization is functionally integrated, (3) the modified responsiveness test for Type III supporting organizations that are organized as charitable trusts, and (4) the type of information a Type III supporting organization will be required to provide to its supported organization(s) to demonstrate that it is responsive.

### **Explanation of Provisions**

Summary of Proposed Criteria for Qualifying as a Type III Supporting Organization

The Treasury Department and the IRS expect that all Type III supporting organizations will be required to meet the responsiveness test under Treas. Reg. §1.509(a)-4(i)(2)(ii). In addition, it is expected that Type III supporting organizations that are functionally integrated will be required to meet: (A) the “but for” test in existing Treas. Reg. §1.509(a)-4(i)(3)(ii); (B) an expenditure test that will resemble the qualifying distributions test for private operating foundations; and (C) an assets test that will resemble the alternative assets test for private operating foundations. Finally, it is expected that a Type III supporting organization that is not functionally integrated will be required to meet a payout requirement equal to the qualified distribution requirement of a private non-operating foundation. In addition, there will be a limit on the number of publicly supported organizations a non-functionally integrated Type III supporting organization may support. These proposed criteria for qualifying as a Type III supporting organization will replace the integral part test in the existing regulations. These provisions are explained in more detail below.

Definition of Functionally Integrated Type III Supporting Organization and the Applicability of Private Operating Foundation Rules

Private operating foundations under section 4942(j)(3) share strong similarities with Type III functionally integrated supporting organizations under section 4943(f)(5)(B) in that both are expected to be directly engaged in the active conduct of charitable activities rather than only making grants to, or for the

use of, charitable organizations. The Code and Treasury Regulations provide extensive rules used to determine whether a private foundation is a private operating foundation. See section 4942(j)(3) and Treas. Reg. §53.4942(b). The Treasury Department and the IRS believe that these rules provide a useful model for developing standards to determine whether a Type III supporting organization is functionally integrated, and that adoption of similar rules under section 4943(f)(5)(B) will further the Congressional purpose articulated in the Technical Explanation of strengthening the nexus between a functionally integrated Type III supporting organization and the publicly supported organization(s) it supports.

To qualify as a private operating foundation under section 4942(j)(3), an organization must satisfy a qualifying distributions test and one of three alternative tests described below. Under the qualifying distributions test, a private operating foundation must make qualifying distributions “directly for the active conduct of the activities constituting the purpose or function for which it is organized and operated,” equal to substantially all (at least 85 percent) of the lesser of its adjusted net income or its minimum investment return. Under section 4942(e)(1), the minimum investment return is equal to 5 percent of the excess of (A) the aggregate fair market value of all the foundation’s assets other than those used (or held for use) directly in carrying out the organization’s exempt purpose over (B) the acquisition indebtedness with respect to such assets. Under Treas. Reg. §53.4942(b)-1(b)(1), a qualifying distribution directly for the active conduct of activities constituting the foundation’s exempt purpose is a distribution that is used by the foundation itself to carry out its exempt activities

rather than paid to other organizations to help them carry out their exempt activities.

In addition, a private operating foundation must meet one of three alternative tests: an assets test, an endowment test or a support test. The assets test, under section 4942(j)(3)(B)(i) and Treas. Reg. §53.4942(b)-2(a), requires that substantially more than half (at least 65 percent) of the assets of an operating foundation must be devoted directly to the private operating foundation's exempt purpose activities, or to functionally related businesses (see section 4942(j)(4)), or both, or are stock of a corporation controlled by, and substantially all (at least 85 percent) of the assets of which are devoted to, the foundation. The endowment test, under Treas. Reg. §53.4942(b)-2(b), requires a foundation to make qualifying distributions directly for the active conduct of its exempt activities in an amount not less than two thirds of its minimum investment return. The support test, under Treas. Reg. §53.4942(b)-2(c), is satisfied if substantially all (85 percent) of a foundation's support (other than gross investment income) is normally received from the general public and from five or more exempt organizations that are not related to each other or the recipient foundation, if the foundation does not normally receive more than 25 percent of its support from any one such exempt organization; and if the foundation does not normally receive more than 50 percent of its support from gross investment income.

*Description of the Proposed Functionally Integrated Test*

The Treasury Department and the IRS anticipate that the proposed regulations will define the term functionally integrated Type III supporting organization as a Type III supporting organization that meets: (A) the “but for” test in existing Treas. Reg. §1.509(a)-4(i)(3)(ii); (B) an expenditure test consistent with section 4942(j)(3)(A); and (C) an assets test consistent with section 4942(j)(3)(B)(i). It is expected that the expenditure test will require a functionally integrated Type III supporting organization to use substantially all of the lesser of (a) its adjusted net income or (b) five percent of the aggregate fair market value of all its assets (other than assets that are used, or held for use, directly in supporting the charitable programs of the supported organizations) directly for the active conduct of activities that directly further the exempt purposes of the organizations it supports. The assets test will require the organization to devote at least 65 percent of the aggregate fair market value of all its assets directly for the active conduct of activities that directly further the exempt purposes of the organizations it supports. The Treasury Department and the IRS believe that requiring functionally integrated Type III supporting organizations to satisfy the expenditure and assets tests, in addition to the “but for” test, will be stronger than the existing integral part test and ensure a sufficient nexus between a supporting organization and the organization(s) it supports. These tests also will ensure that a sufficient amount is being dedicated directly to the active conduct of activities that further the exempt purposes of publicly supported organizations.

The term “adjusted net income” is expected to have substantially the same meaning as that term has in section 4942(f) and Treas. Reg. §53.4942(a)-2(d).

The valuation of assets is expected to be determined in a manner similar to the rules under section 4942(e)(2) and Treas. Reg. §53.4942(a)-2(c)(4).

The Treasury Department and the IRS also intend that certain Type III supporting organizations that oversee or facilitate the operation of an integrated system that includes one or more charities and that may be unable to satisfy the “direct active conduct” and “directly further” requirements of the expenditure and assets tests, such as certain hospital systems, will be classified as functionally integrated in the proposed regulations if they satisfy the existing “but for” test.

The proposed regulations will not permit a functionally integrated Type III supporting organization to qualify as functionally integrated by using the endowment or support tests that are available to private operating foundations as alternatives to the proposed assets test. Because the endowment test is similar to the expenditure test, the Treasury Department and the IRS believe that the endowment test would not provide sufficient additional assurances of a tight nexus between a functionally integrated supporting organization and its supported organizations. Furthermore the support test, which focuses on sources of support received by a private foundation rather than on its activities, appears to be inapplicable to the functionally integrated concept. By requiring at least 65 percent of the value of all assets of each functionally integrated supporting organization to be devoted directly for the active conduct of the activities of its supported organizations, the proposed assets test is intended to ensure that the connection between the supporting and supported organizations is significant.

*Payout Requirement for Type III Supporting Organizations that are not Functionally Integrated*

In establishing a payout requirement for non-functionally integrated Type III supporting organizations, the Treasury Department and the IRS expect to follow the framework of the existing section 4942 qualifying distribution regulations applicable to private non-operating foundations. Private non-operating foundations have operated under these qualifying distribution regulations for many years. The Treasury Department and the IRS believe these rules are appropriate for Type III grant-making organizations, and would further the Congressional purpose articulated in the Technical Explanation of ensuring that, as compared to amounts paid out by private non-operating foundations, significant amounts are being paid to supported organizations even if the supporting organization's assets produce little or no income.

A private non-operating foundation is required under section 4942 to make certain qualifying distributions or pay an excise tax. A private non-operating foundation is generally liable for this excise tax under section 4942(a) and (b) if it does not make qualifying distributions each year equal to its minimum investment return. The minimum investment return is five percent of the aggregate fair market value of all the foundation's assets other than those used (or held for use) directly in carrying out the organization's exempt purpose over the acquisition indebtedness with respect to such assets. Qualifying distributions under section 4942(g) are generally those distributions (including reasonable and necessary administrative expenses) paid to accomplish charitable purposes.

### Description of the Proposed Payout Rule

The Treasury Department and the IRS anticipate that the proposed regulations will (A) require a non-functionally integrated Type III supporting organization to meet a payout requirement and (B) limit the number of publicly supported organizations a non-functionally integrated Type III supporting organization may support. .

The payout requirement will call for a Type III supporting organization that is not functionally integrated to distribute annually to or for the use of its supported organizations an amount equal to at least five percent of the aggregate fair market value of all its assets (other than assets that are used, or held for use, directly in supporting the charitable programs of its supported organizations). Additionally, the Treasury Department and the IRS are concerned that a supporting organization's relationship with and accountability to its supported organizations is diminished as the number of its supported organizations increases. Accordingly, except for organizations in existence on or before the date the regulations are proposed, it is expected that the proposed regulations will also provide that non-functionally integrated Type III supporting organizations will be limited to supporting no more than five publicly supported organizations. An organization in existence on or prior to the date regulations are proposed may support more than five supported organizations only if the organization distributes at least 85 percent of its total required payout amount to, or for the use of, publicly supported organizations to which the supporting organization is responsive pursuant to Treas. Reg. §1.509(a)-4(i)(2)(ii). The

anticipated proposed payout rules are intended to ensure that a non-functionally integrated Type III supporting organization has a tight nexus with its supported organization(s).

The Treasury Department and the IRS recognize that requiring an existing Type III supporting organization that supports more than five supported organizations to provide 85 percent of its total required payout to those supported organizations to which it is responsive may affect existing donee relationships. The Treasury Department and the IRS solicit comments on whether transitional rules are needed with respect to this proposed limitation regarding distributions to supported organizations.

The valuation of assets for purposes of the payout requirement is expected to be determined in a manner similar to that under section 4942(e)(2) and Treas. Reg. §53.4942(a)-2(c)(4). The proposed distribution rules will be similar to the distribution rules under section 4942. It is expected that amounts paid by an organization to accomplish the exempt purposes of its supported organizations will be considered as distributed to or for the use of its supported organization(s).

#### *Responsiveness Test*

Except as explained below with respect to charitable trusts, the Treasury Department and the IRS do not expect to modify the responsiveness test. Thus, all Type III supporting organizations will be expected to meet the responsiveness test under Treas. Reg. §1.509(a)-4(i)(2)(ii). Accordingly, a Type III supporting organization will be expected to demonstrate the necessary relationship between

its officers, directors or trustees and those of its supported organization(s), and further show that this relationship results in the officers, directors or trustees of its supported organization(s) having a significant voice in the operations of the supporting organization.

#### *Responsiveness Test for Charitable Trusts*

Consistent with section 1241(c) of the PPA, discussed in the Background section above, the proposed regulations will provide that charitable trusts must satisfy the responsiveness test under Treas. Reg. §1.509(a)-4(i)(2)(ii). Thus, for instance, a trust would be expected to show that its trustees have a close, continuous working relationship with the officers, directors, or trustees of the publicly supported organization(s) it supports and that through such relationship the officers, directors or trustees of its publicly supported organization(s) have a significant voice in the operations of the supporting organization. Comments are requested with respect to potential transition relief given that the statute directs that this modified test apply as of August 17, 2007 to trusts already in existence on the date of enactment of the PPA.

#### *Requirement to Provide Supported Organizations with Information Regarding Responsiveness*

The proposed regulations will provide rules for the form, content and timing of the information Type III supporting organizations are required to provide their supported organization(s) under section 509(f)(1)(A). The Treasury Department and the IRS solicit comments as to what information the Secretary should require a Type III supporting organization to provide to each of its

supported organizations to ensure that such supporting organization is responsive to the needs or demands of its supported organization(s).

#### *Consequences for Failing to Satisfy the Proposed Tests*

The proposed regulations will clarify that an organization that would otherwise be classified as a Type III supporting organization, but either does not establish that it is functionally integrated or does not satisfy the payout requirement for non-functionally integrated organizations in a taxable year, will be classified as a private foundation for such taxable year and all subsequent taxable years until it terminates its private foundation status under section 507. The Treasury Department and the IRS solicit comments on how the requirements for a private foundation termination under section 507 should apply in these circumstances.

#### *Transitional Issues*

Implementation of the new qualification requirements for Type III supporting organizations enacted in the PPA will raise transitional issues for certain organizations. For instance, an organization that currently qualifies as a Type III supporting organization by meeting the attentiveness prong of the integral part test might be prohibited by its current governing instrument from distributing capital or corpus, thus preventing it from being able to satisfy the new payout requirement for non-functionally integrated Type III supporting organizations without a change to such instrument. The Treasury Department and the IRS invite comments regarding potential transition rules for supporting organizations in existence as of the date of enactment of the PPA that will

provide such organizations a reasonable opportunity to amend their governing instruments or make other changes to comply with the law as amended by the PPA.

*Proposed Effective Date*

Except as otherwise noted, the Treasury Department and the IRS anticipate that these new proposed rules for Type III supporting organizations would apply to taxable years with respect to each organization beginning after the date these rules are published in the Federal Register as final or temporary regulations.

**Request for Comments**

Before the notice of proposed rulemaking is issued, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. All comments will be available for public inspection and copying.

**Drafting Information**

The principal authors of this advance notice of proposed rulemaking are Philip T. Hackney and Michael B. Blumenfeld, Office of the Chief Counsel (Tax-exempt and Government Entities), however, other personnel from the IRS and the Treasury Department participated in its development.

Kevin M. Brown

Deputy Commissioner for Services and Enforcement.